

Report Type

Mid Term Award Report

Full Name

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Faculty/Department

CJBS

Project Title

The dynamics of corporate financial policies, group decisions, and coalition formation.

Project Start Date

Feb 01, 2021

Project End Date

Feb 01, 2023

Project Abstract

This research studies the dynamics of the three main corporate policies: the investment, financing and payout decisions. We first study how these decisions interact, and whether the theories of corporate capital structure and payout can be reconciled with each other given these interactions. Next, we study investment and payout decisions made by a group of investors. We examine the formation, composition, efficiency, evolution and stability of the decision-making coalitions.

Traditionally, the finance literature has studied the firm's three main financial policies in isolation. However, in reality these three key corporate decisions are not independent as they are linked by the firm's sources and uses of funds constraint. The interdependencies between the firm's policies raise many questions that have not been recognized in the existing literature. For example, if we believe that firms follow a target leverage ratio, what are the implications for the dynamics of payout and investment? Alternatively, what are the implications for payout and investment if firms follow a pecking order policy? Our research aims to explore these questions from a theoretical perspective, with a view to produce empirical predictions as to how payout, investment and capital interact.

In the second project, we want to develop a dynamic model that examines the formation, composition, evolution and stability of decision-making coalitions. In particular, we want to study how the sharing rules, cooperation and bargaining among agents affects the composition of a ruling coalition when the profits to be shared are uncertain. We want to examine how the composition of the coalition evolves as profits change and identify conditions that yield stable coalitions.

Activities and Achievement

The grant started on 1 February 2021. For the first two months of the grant period, we have focused on the first project, and have made significant progress. The project examines whether capital structure models square with the dynamics of payout. We explore whether theoretically the target leverage and pecking order models can be reconciled with payout smoothing. We have obtained a number of interesting results so far. We show that investment absorbs a significant part of income and asset volatility if the firm follows both a payout target and a net debt ratio (NDR) target. A positive (negative) NDR amplifies (dampens) shocks in assets. Slow adjustment towards the NDR target facilitates payout smoothing. On the other hand, under strict pecking order financing, income shocks are absorbed primarily by changes in net debt. More payout smoothing implies a stronger negative relation between debt and net income. Shocks to assets in place need not affect

current payout.

The first paper is not ready for dissemination yet, but we hope it will be ready by the next board meeting in October 2021

The second project is still in a very initial stage. We have started working on the model setup. We aim to fully concentrate on this project after we finish the first project.

Dissemination

The grant started on 1 February. As we are still in the initial stage of the grant, we do not have a paper yet that is ready for dissemination.

Outputs

We are still in the initial stage of the grant and do not have a paper yet that is ready for dissemination.

Major Difficulties and Any Other Issues

None

Web Links

We are still in the initial stage of the grant and do not have output that is ready for public dissemination.

Additional Information

Declaration

This award has not yet produced any relevant outputs, but details of any future publications will be submitted to the CERF database as soon as they become available.